

This letter concerns the taxability of maintenance agreements. See 86 Ill. Adm. Code 140.101. (This is a GIL.)

December 31, 2007

Dear Xxxxx:

This letter is in response to your letter dated April 11, 2007, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

We are requesting your *written* sales and use tax opinion on services that our company provides.

**Current situation**

1. ABC currently has a principal office located in CITY, California. Consequently, we are 'engaged in business' in CITY2, California.

**We are an out-of-state service provider**

2. We are involved in providing Maintenance and Support services for Telecommunication PBX's to our customers nationwide and are planning on offering services in Illinois in the near future.
3. We have maintenance / service agreements with end-user customers for their telecommunications PBX equipment.
4. We sell maintenance agreements remotely by telephone and e-mail.
5. If the customer needs local service, we dispatch a local Illinois subcontractor / technician and / or company in the customer's area. The subcontractor /

company bills us on a Time & Material basis for any service used. Our understanding is that **we do not have nexus in Illinois.**

6. Also, we understand **the labor use is not subject to sales or use tax.**
7. We would bill the Illinois customer monthly as per the maintenance / service agreement; **the invoiced amount is not subject to sales or use tax.**
8. If a maintenance customer in Illinois has a piece of equipment that becomes defective, we ship them a maintenance replacement unit on an exchange basis and the customer ships the defective equipment back to us. We have paid California sales or use tax on the equipment we have for maintenance replacements.

We hope that the information above will help you confirm that the above statements are correct. Should you have further questions I can be reached at #.

Thank you for your help in this matter.

## DEPARTMENT'S RESPONSE:

### NEXUS

In your letter you state that it is your understanding that ABC does not have nexus in Illinois. The Department cannot confirm your understanding. The Department declines to make nexus determinations in the context of Private Letter Rulings or General Information Letters because the amount of information required to make such determinations is often best gathered by an auditor. However, the following information outlines the principles of nexus. We hope it is helpful to you in determining your Company's tax obligations.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i). This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), established the current guidelines for determining the nexus requirements that must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails himself or itself of the benefits of an economic market in a forum state. *Quill* at 1910. The second prong of the Supreme Court's nexus test requires, if due process requirements have been satisfied, that the person or entity have a physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of

the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please see *Brown's Furniture, Inc. v. Wagner*, 171 Ill.2d 410, (1996).

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax liability on the purchase of the goods and have a duty to self-assess and remit their Use Tax liability directly to the State. In such instances, those customers must remit their Illinois Use Tax along with a completed Form ST-44, Illinois Use Tax Return, unless they are otherwise registered or are required to be registered with the Department and remit their Illinois Use Tax with a Form ST-1, Illinois Sales and Use Tax Return. Many retailers that do not have nexus with the State have chosen to voluntarily register as Use Tax collectors as a courtesy to their Illinois customers so that those customers are not required to file returns concerning the transactions with those retailers.

## MAINTENANCE AGREEMENTS

The taxability of a maintenance agreement depends upon whether the charge for the agreement is included in the selling price of tangible personal property. If the charge for the agreement is included in the selling price of tangible personal property, the charge is part of the gross receipts of the retail transaction and is subject to tax. No tax is incurred on the maintenance services or parts when the repair or servicing is performed.

If a maintenance agreement is sold separately from tangible personal property, the sale of the agreement is not a taxable transaction. However, when maintenance services or parts are provided under the terms of the maintenance agreement, the seller of the maintenance agreement will be acting as a service provider under provisions of the Service Occupation Tax Act. The Service Occupation Tax provides that when a service provider enters into an agreement to provide maintenance services for particular pieces of equipment for a stated period of time at predetermined fees, the service provider incurs Use Tax based on its cost price of tangible personal property transferred to the customer incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3). Further, the purchaser of the separate agreement is not charged tax on the labor or tangible personal property that is transferred incident to the completion of the maintenance agreement. If a deductible is charged to the purchaser under the terms of the separate agreement, the deductible is also not subject to tax.

## SERVICE OCCUPATION TAX

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. See 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois.

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. For your general information see of 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (i.e. servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. The serviceman's liability may be calculated in one of four ways: (1) separately-stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately-stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. See 86 Ill. Adm. Code 140.109. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen also collect a corresponding amount of Service Use Tax from their customers, absent an exemption.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See 86 Ill. Adm. Code 140.108.

## MULTI-SERVICE SITUATIONS

Your letter states that the Company may use a third-party provider for the performance of certain services. Please be informed that firms who do service work for customers of another business are sometimes secondary servicemen in multi-service situations. Multi-service situations exist where a primary serviceman subcontracts work to a secondary serviceman. See 86 Ill. Adm. Code 140.145 for information about multi-service situations.

I hope this information is helpful. If you require additional information, please visit our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) or contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Richard S. Wolters  
Associate Counsel

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